السعودي الفرنسي كابيتال
Saudi Fransi Capital

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SAUDI MARKET MID-YEAR UPDATE

WHERE TO FROM HERE?

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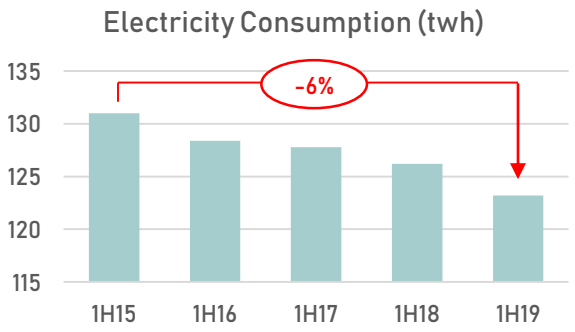
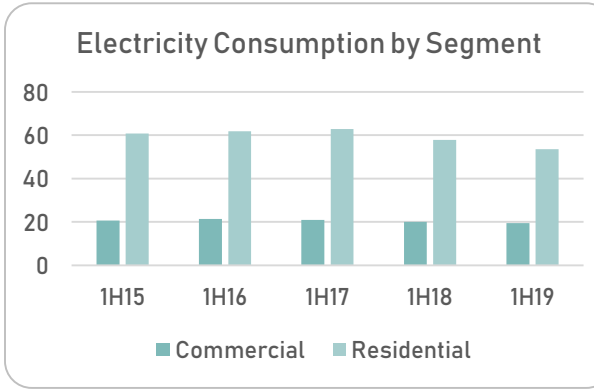
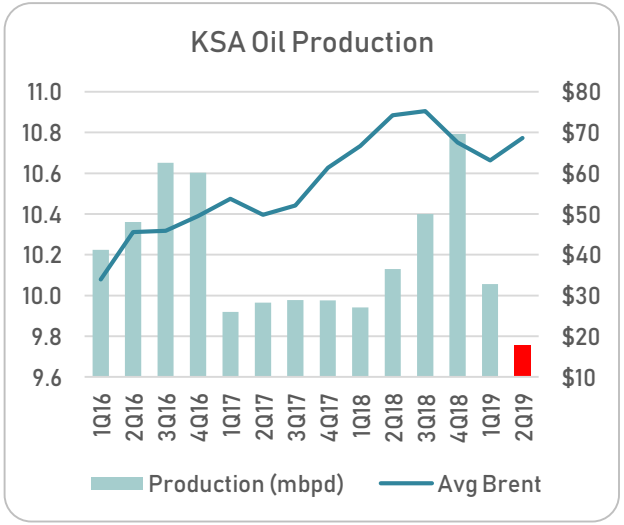
ECONOMIC PROGRESS THROUGH FIRST HALF

- IMF revised KSA GDP growth forecast higher by +0.1 ppt and +0.9 ppt for 2019 and 2020 since January, while cutting global outlook
- Average oil production declined below 9.8 mbpd in 2Q19 - lowest since 1Q16, however Brent averaged $66 in 1H19 vs $70 in 1H18
- Electricity consumption can be a gauge of economic activity, In KSA usage dropped -6% since 1H15, contributing factors include:
  - Tariff increase leading to rationalization
  - Expat outflow
- Residential usage declined -14% since 1H16, while Commercial dropped -9%
- Plans to allow 24h commercial activity could spur growth, however:
  - What will drive footfall increase? Female consumers?
  - Higher disposable incomes will be main driver
- Revenues tracking higher against 2019 target of SR 975 bn while spending is below SR 1,106 bn budget
- Sharp pick-up in capital spending during 1H19

GDP Growth	2017	2018	2019F	2020F
World	3.8	3.6	3.2	3.5
US	2.2	2.9	2.6	1.9
China	6.8	6.6	6.2	6.0
KSA	-0.7	2.2	1.9	3.0





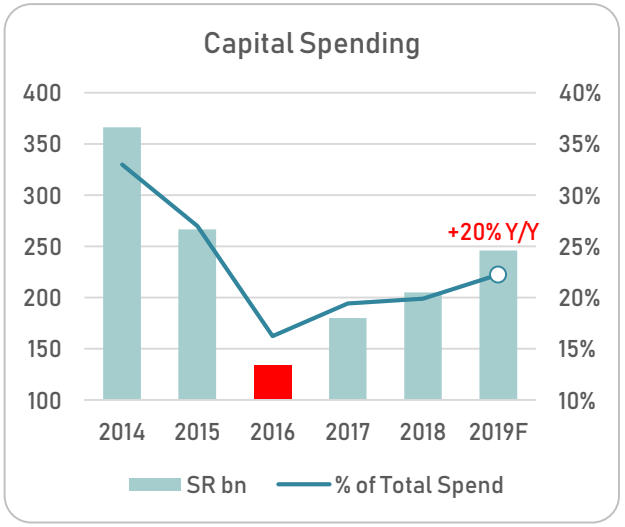


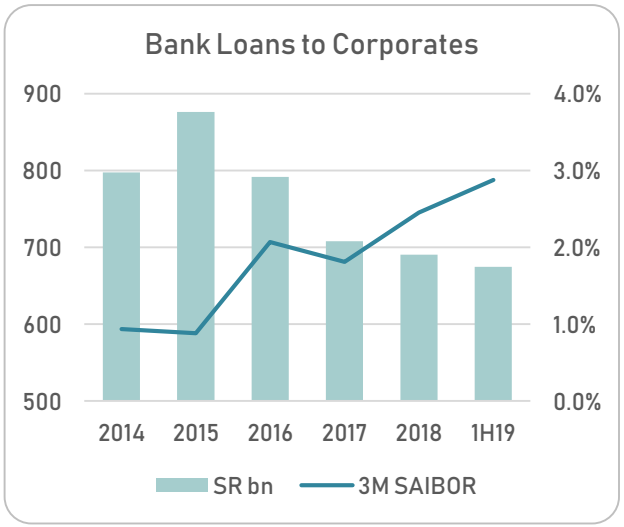
Fiscal Snapshot (SR bn)	1H19	1H18	Y/Y Chg
Revenues	506	440	+15%
Oil	344	298	+15%
Non-oil	162	142	+14%
Expenditure	512	482	+6%
Compensation	252	244	+4%
Capital	90	74	+22%
Other	170	164	+4%
Deficit	(6)	(42)	
Public Debt	628	537	+17%

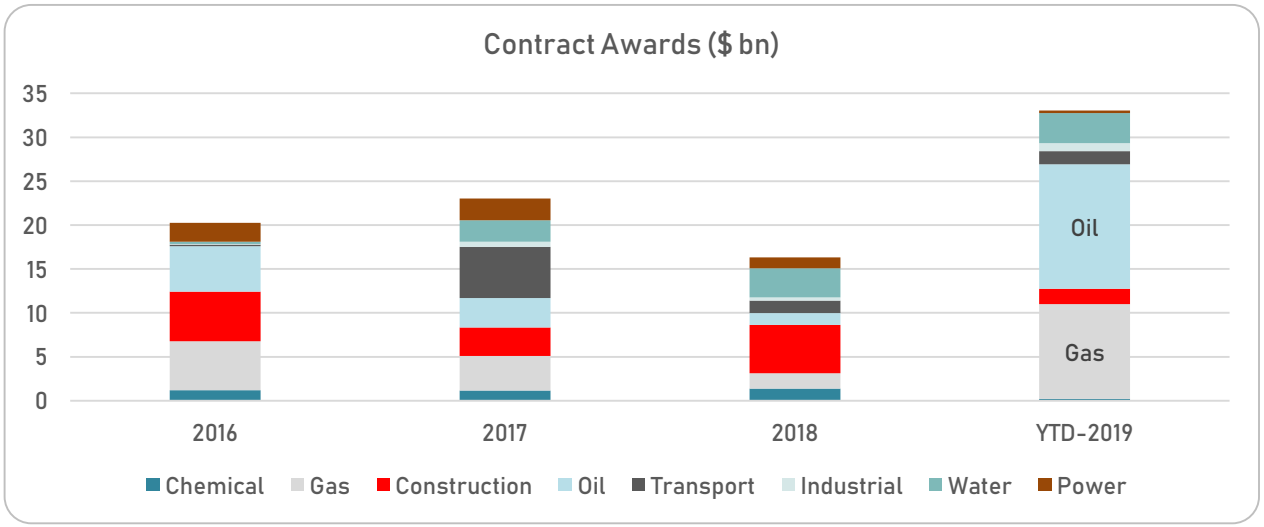
Source: JODI, OPEC, IMF, MoF, Saudi Electricity, SFC

CAPITAL SPENDING

- Capital spending recovering from 2016 lows – targeted growth of +20% in 2019
- Given supportive fiscal progress in 1H, spending plans should remain intact even if Brent remains in $55 to $60 range
- Bank loans to corporates remained subdued, however recovery possible as projects break ground
- 1H19 net loan growth of +1.9% driven by government borrowing
- Contract awards gained momentum in 2019, topping $33 bn:
  - Oil and Gas major recipients
  - Construction and Transport awards curtailed
- Commerce, Manufacturing and Construction comprise 38% of total bank credit



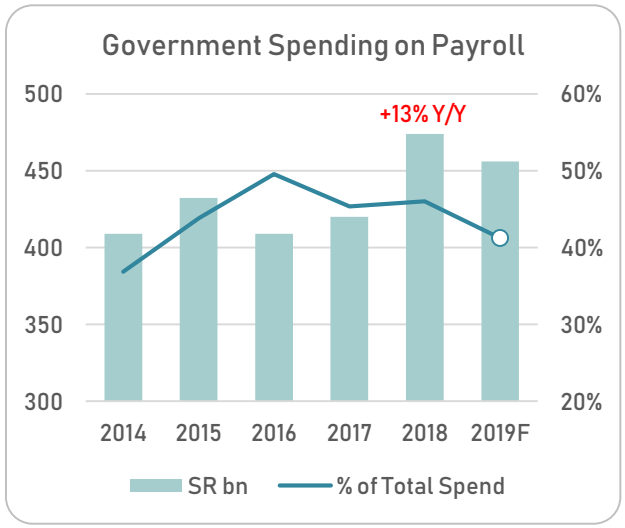


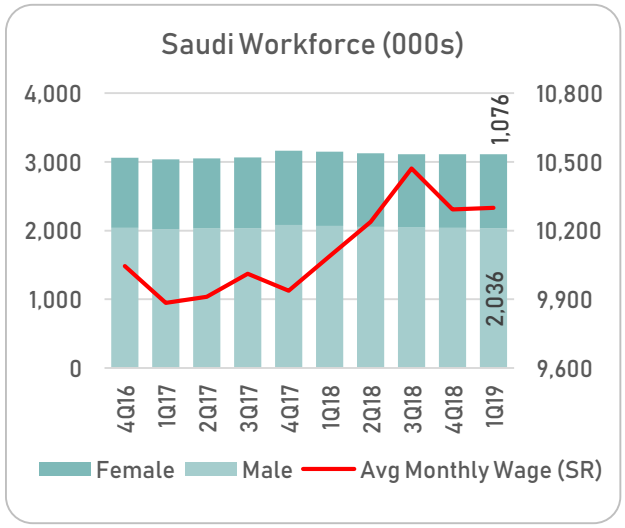


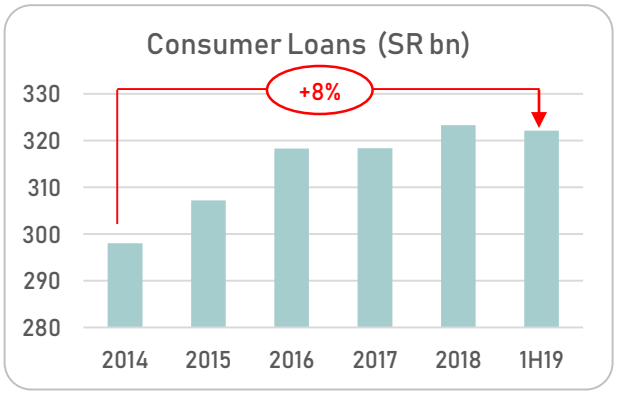
Source: MoF, SAMA, MEED, SFC

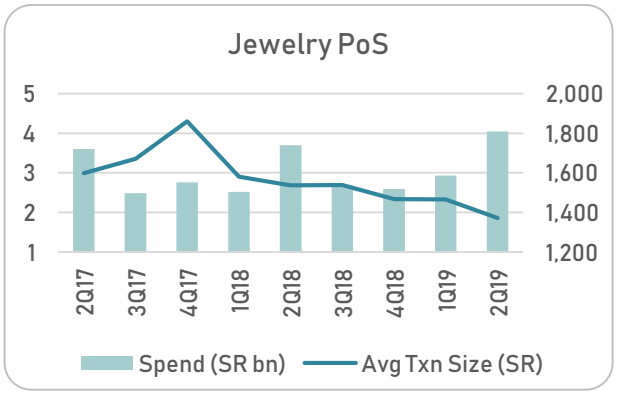
CONSUMER SPENDING

- Payroll gained +13% last year, comprising 46% of total government spending
- However, total employed Saudis declined by 38k in the trailing 12M through 1Q19
- Growth in average monthly wage suggests higher value job creation and better educated workforce, setting stage for:
  - Increased home ownership
  - Higher spending power
- New mortgage contracts topped 29k in 1H19 vs 12k in 1H18, creating demand for household goods (appliances, furniture)
- Although aggregate consumer loans are flat through 1H19, spending trends appear encouraging:
  - Jewelry purchase increased during key Ramadan/Eid season – although average txn size declined on stronger gold
- F&B jumped +26%, suggesting easing consumer caution and moderating impact of expat outflow
- Clothing and Electronics showing modest improvement - these categories are becoming essential for daily work/student life
- Hotel spending remains under pressure, down -6%









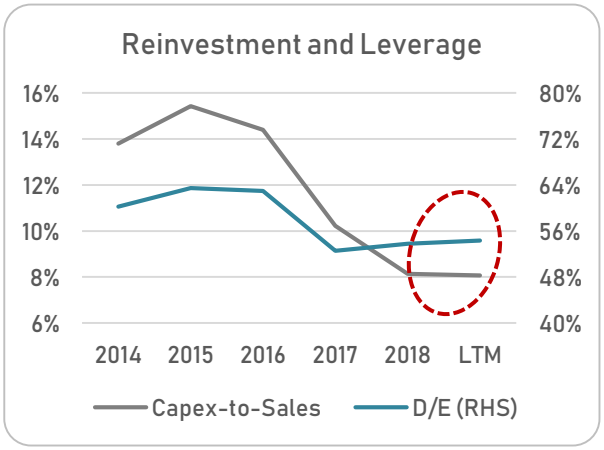
PoS Indicators (SR mn)	1H19	Y/Y Chg
Food & Beverage	17,766	+26%
Clothing & Footwear	16,009	+7%
Electronics	4,783	+3%
Hotels	4,511	-6%

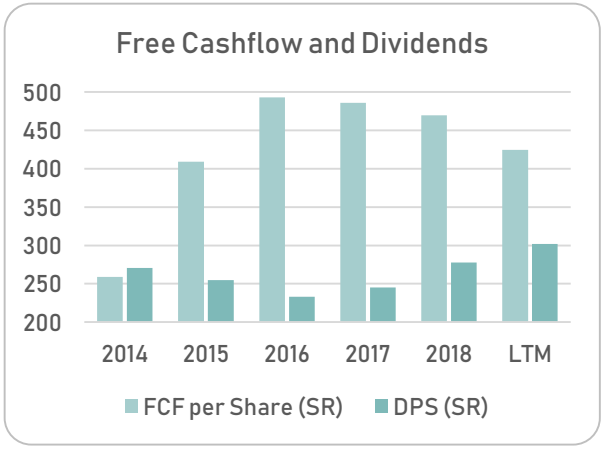
Source: MoF, SAMA, GA Stat, SFC

EARNINGS SUMMARY AND TRENDS

- Market earnings decline accelerated in 2Q to -33% Y/Y largely driven by Petrochemicals
- 1H19 earnings dropped -25% compared to our forecast of +2.5% and consensus +20% for 2019
- Gross margin tightened 400 bps to 27%, while IFRS 16 impacted retailers and businesses with extensive network
- Cements mounted a remarkable turnaround in earnings on exports and product price improvement
- Retailers had a decent first half, suggesting improvement in discretionary spending, gross margin gained 190 bps
- Healthcare and Insurance continued to struggle with double-digit earnings contraction
- Companies are reinvesting substantially less than 2014 levels while leverage shows modest uptrend, likely to bridge working capital needs
- Free cashflow has trended lower since 2016 while dividends have increased, indicating lower investment appetite

1H19 Market Earnings	Y/Y Change	1H19 Revenues	Y/Y Change
SR 41.2 bn	-25%	SR 270 bn	-6%



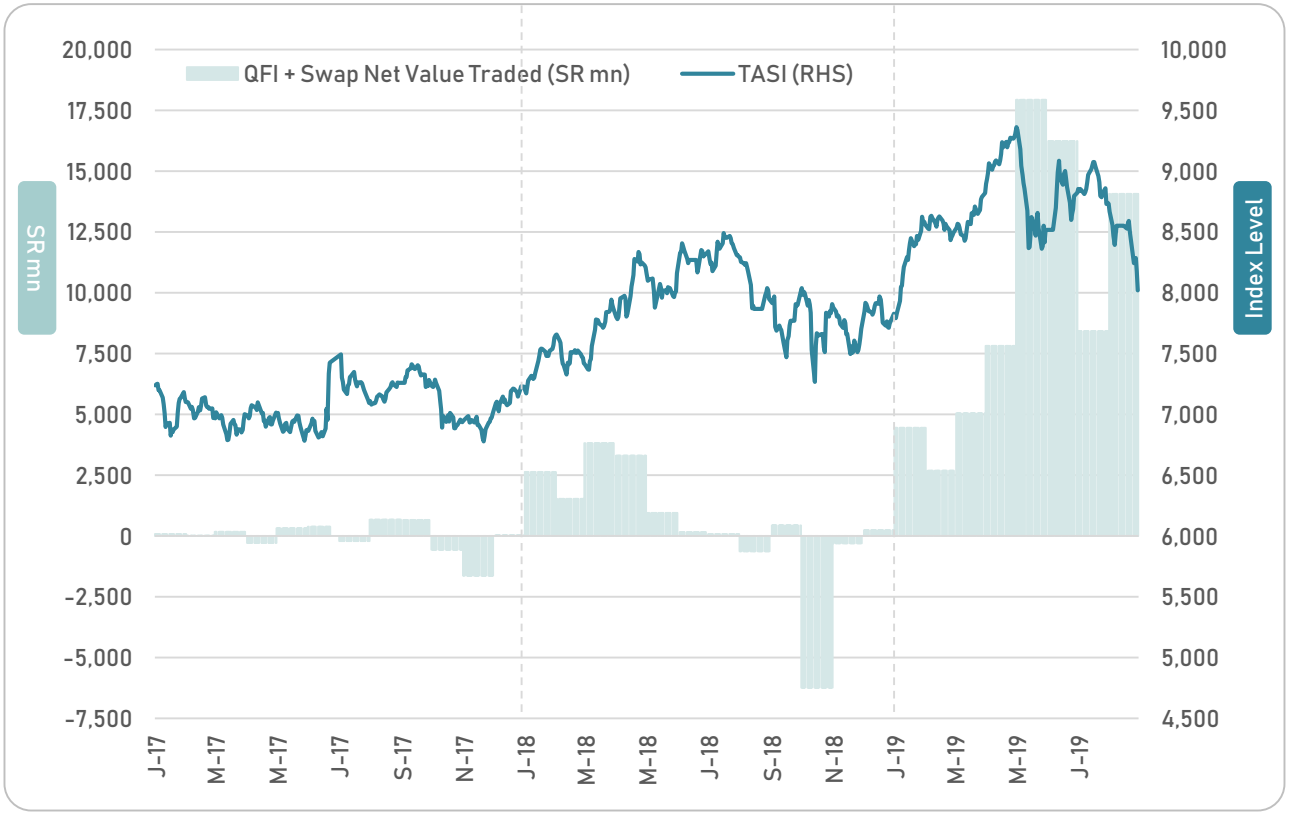


Select Sectors Earnings (SR bn)	1H17	1H18	1H19
Banks	23.0	23.4	22.5
Y/Y Chg	*-1.5%*	*+1.7%*	*-3.8%*
Petrochemicals	13.2	20.0	8.1
Y/Y Chg	*+21%*	*+52%*	*-59%*
Cements	1.3	0.4	1.1
Y/Y Chg	*-56%*	*-73%*	*+210%*
Real Estate	0.5	0.5	0.4
Y/Y Chg	*-49%*	*-10%*	*-17%*
Food & Beverage	1.4	1.2	1.1
Y/Y Chg	*-16%*	*-17%*	*-11%*
Retail	1.0	0.7	0.7
Y/Y Chg	*+20%*	*-32%*	*+12%*
Healthcare	0.6	0.5	0.4
Y/Y Chg	*+3.8%*	*-15%*	*-26%*
Insurance	0.7	0.6	0.5
Y/Y Chg	*-15%*	*-12%*	*-20%*

Source: Tadawul, Bloomberg, SFC

MARKET PERFORMANCE

- Market trajectory turned negative in the last 3M (-5.8%) on weaker commodity prices and below forecast earnings
- YTD net foreign inflows (QFIs & Swaps) totaled SR 76.6 bn vs SR 5.9 bn in 2018
  - 53% of the inflows coincided with MSCI 2-tranche implementation
  - We estimate 55% passive and 45% active foreign investor make-up
- MSCI EM performance has been under pressure on trade tensions and fears of strengthening USD
- Telecommunications has been a key outperforming sector YTD, however Banks have provided crucial support to the market



Performance (%)	TASI	MSCI EM	Brent
3-Mth	-5.8	-1.4	-11.4
6-Mth	-6.0	-6.4	-10.3
1-YR	+0.9	-6.8	-23.8
YTD	+2.5	+1.9	+10.1

Key Sectors Performance (%)	3-Mth	1-YR	YTD
Banks	-11.0	+10.1	+4.8
Telecommunications	+1.8	+26.6	+17.1
Retailing	-2.3	+11.5	+3.4
Materials	-6.1	-13.1	-4.0

Note: As of 1 Sep 2019

Source: Tadawul, Bloomberg, SFC

MARKET RATIOS AND VALUATION MULTIPLES

- TASI commands premium P/E to MSCI EM at 20.4x, reflecting strong margins, benign leverage and superior dividend yield
- Consensus view remains optimistic projecting nearly +20% 2019 earnings growth
- As forecasts adjust lower, expect market multiples compression
- At current levels, some sectors appear relatively cheap to their EM peers, for example:
  - Telecommunications
  - Healthcare
  - Consumer Services
  - Transportation

Ratios	TASI	MSCI EM
ROE (%)	8.9	11.6
Debt-to-Equity (x)	0.5	1.0
Net Debt-to-EBITDA (x)	0.6	1.8
Dividend Yield (%)	3.7	3.0

Valuation – Trailing (x)	TASI	MSCI EM
P/E	20.4	12.9
EV/EBITDA	12.7	8.3
P/B	1.8	1.5
P/Cashflow	13.7	8.2

Margins (%)	TASI	MSCI EM
EBITDA	36	20
Operating	20	12
Net	16	9

Growth – 2019E (%)	TASI	MSCI EM
Revenue	0.6	-2.3
Earnings	19.6	-6.5
Dividend	-0.9	5.0

Sector P/E – Trailing (x)	TASI	MSCI EM
Banks	13.8	8.4
Telecom Services	21.0	24.3
Utilities	90.8	11.7
Diversified Financials	160.0	12.4
Real Estate Mgmt & Dev	54.0	7.7
REITs	15.3	12.3
Insurance	139.8	9.6
Pharma	n.m.	21.6
Healthcare	28.1	28.3
Food & Beverage	26.3	25.8

Sector P/E – Trailing (x)	TASI	MSCI EM
Food & Staples Retail	34.6	23.0
Retailing	34.9	17.4
Media	50.2	29.4
Consumer Services	20.2	32.6
Consumer Durables	56.7	22.2
Transportation	18.0	18.6
Commercial & Prof Serv	20.5	18.2
Capital Goods	n.m.	10.8
Energy	36.4	7.4
Materials	25.9	12.8

Note: As of 28 Aug 2019

Source: Tadawul, Bloomberg, SFC

MARKET OUTLOOK FOR NEXT 6 MONTHS

- Economy progressing on track
  - Room to sustain / grow government spending
  - Project awards spiked in July suggesting healthy pipeline
  - Bank credit has been subdued but encouraging prospect as projects move towards implementation
- Business sentiment has yet to show meaningful improvement, looking for increased capex and hiring
- Consumer sentiment has recovered from 2016/17 lows
  - Growth in F&B spend, despite no substantial population increase (i.e. expats)
  - Discretionary spending picking-up while discounting pressure appears to be easing (margin contraction contained)
- 2020 State Budget announcement in 4Q could be a market catalyst, in particular Cements and Building Materials may benefit from new development programs
- Energy price and tax amendments appear low probability (increase in selective tax to take effect around end-2019)
- Key risk remains weakening oil price beyond fiscal-sensitive level (i.e. sub-$55) raises market correlation, which this year was overshadowed by index flows
- Further support from foreign flows subject to market fundamentals
  - YTD foreign buying and selling comprised 30% and 16% of total vs 5% and 5% in 2018, suggesting key driver of demand
  - If the passive-active ratio holds, then 45% of foreign trading activity will take direction from fundamentals and alternative markets
  - In terms of currency-adjusted returns, KSA should be attractive

Y/Y Change in 2019 Earnings	Target P/E (x)				
	17.5	18.5	19.5	20.4	21.0
+5%	7,810	8,256	8,702	9,104	9,372
+2%	7,587	8,020	8,454	8,844	9,104
0%	7,438	7,863	8,288	8,671	8,926
-15%	6,322	6,684	7,045	7,370	7,587
-25%	5,578	5,897	6,216	6,503	6,694

- Assuming flat 2019 earnings and prevailing P/E implies fair value of 8,671 over the next 6months
- Considering that 1H19 earnings were -25% Y/Y, full-year decline is more probable. We see 2019 earnings at -15% Y/Y
- Market multiples are expected to revert to their historical premiums vis-à-vis MSCI EM. In our view, this equates to 18.5x, resulting in market fair value of 6,684

Source: Tadawul, SFC

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